



Who Pays When the ‘Loser Pays’? Considering Practical Issues, Misperceptions and Options

BY VICTOR E. SCHWARTZ AND GARY SILVERMAN

In recent months, state officials have expressed significant interest in adopting “loser pays” – a system under which the losing party in a lawsuit must pay the opposing party’s attorneys’ fees and costs. Texas Governor Rick Perry touted his state’s enactment of a “loser pay” law on the campaign trail. South Carolina

Governor Nikki Haley, in an address at the U.S. Chamber of Commerce’s annual Tort Reform Summit, declared loser pays to be among her top civil justice priorities. In 2012, New Hampshire and Tennessee considered forms of loser-pays bills.

A loser-pays system has strong appeal. After all, even when an individual or business “wins” a lawsuit, the cost of defending against a meritless claim can easily rise into the tens or hundreds of thousands

of dollars. These expenses, which are typically not recoverable, become a cost of doing business in America—it is part of the “tort tax.” Theoretically, a loser-pays law should deter lawyers from filing weak claims. Some respected scholars and advocacy groups strongly support a loser-pays system.¹ There are questions, however, as to whether the pure form of a loser-pays law, known as the “English Rule” achieves this result in practice.

Given the rising interest in enacting loser-pays laws, it is important to consider how these laws might work in court, some common misperceptions, and legislative options. Some have expressed concern that a loser-pays system will be unevenly applied against defendants—adding attorneys’ fees on top of liability that many already generally view as excessive. Legislation strengthening rules against frivolous claims and vexatious litigants may provide a better option.

DOES “LOSER PAYS” MEAN “DEFENDANT PAYS”?

A recent panel discussion hosted by the American Tort Reform Association (ATRA) featured three practitioners with a combined 80 years of trial experience defending manufacturers in product liability lawsuits. They shared their common view that while a loser-pays law may explicitly state that it applies to both sides in litigation, in the courtroom judges would apply it unequally to impose additional liability on a losing defendant. On the other hand, the participating litigators believed that plaintiffs who lose meritless lawsuits would be let off the hook. There are two reasons why: resources and judicial discretion.

Plaintiffs in personal injury cases typically hire lawyers on a contingency-fee basis because they do not have money available to pay an attorney’s hourly rates. Should a prevailing defendant attempt to collect attorney’s fees from a losing plaintiff, it would often find that the plaintiff is “judgment proof” and has no money to pay. In these situations, seeking recovery of attorneys’ fees would be spending more money to chase money that does not exist.

In addition, a loser-pays law will likely provide some discretion to judges as to when to impose attorneys' fees. When an individual plaintiff loses after battling a "deep-pocket" defendant, sympathetic judges are likely to relieve plaintiffs of their obligation to pay the significant cost of a law firm's hourly rates to defend against the claim. In contrast, a plaintiff who prevails when suing a business will likely receive the entirety of his or her costs and fees.

THREE COMMON MISPERCEPTIONS

1. Loser Pays Works in Other Countries, so it Would Work Here.

Although some countries use a loser-pays system, there are significant differences between their legal systems and insurance environments and our own. It should also not be overlooked that loser-pays systems come with their own exceptions, challenges, and flaws.

Outside the United States, legal systems do not widely use (or permit) contingency-fee agreements. Since personal injury lawyers in the U.S. stand to go uncompensated if their client loses a case, they have a disincentive to bring cases with little likelihood of recovery that is not present where they are paid an hourly fee. For that reason, arguably, there is less need for a loser-pays system here than in countries where contingency-fee agreements are not commonly used.

Individuals in countries such as England and Canada that have a loser-pays system, have insurance that covers them should they bring and lose a lawsuit. While an insurance market could develop in the United States to cover attorney's fees incurred as a result of losing litigation should a state enact a loser-pays law, such a concept could face resistance. It would inject insurers into decisions as whether or not to bring claims and possibly other litigation choices. It is also important to recognize that there are exceptions to loser pays in countries that follow this system. For instance, in Britain, plaintiffs whose cases are brought through legal aid are not required to pay the prevailing party's attorneys' fees.

While loser pays might tempt a plaintiff (or his or her lawyer) to think twice before bringing a claim that clearly lacks merit, some observers of the English system point out that loser pays encourage plaintiffs to bring strong cases involving trivial amounts.² By eliminating the expense of the litigation from the plaintiffs' attorneys' lawsuit-bringing calculus, nuisance claims suddenly become highly profitable. Attorneys' fees in such cases can dwarf a client's recovery. We already see this occur in the American civil justice system where consumer protection statutes— in California and elsewhere— that authorize a prevailing plaintiff to recover attorneys' fees have led to the development of a cottage industry for lawyers specializing in suing small restaurants and shops for technical violations of disabled-access laws.³

Administration of a loser-pays system also has its own significant challenges, such as determining who is a "prevailing" party. It is common for lawsuits to include several claims. If five of a plaintiff's six claims for relief are dismissed, but a single claim results in a plaintiffs' verdict, is that plaintiff entitled to recover all of his or her attorneys' fees? What if a jury reaches a plaintiffs' verdict but awards only nominal damages or a tiny fraction of what the plaintiff sought? A defendant may consider the result a victory, but find itself subject to paying attorneys' fees and costs. Such circumstances are likely to result in additional litigation and fee disputes.

2. Alaska Follows Loser Pays.

Alaska is considered the only state that follows loser pays, but it actually follows a limited version of the system that permits only modest recovery of fees and is riddled with exceptions. Consider, for example, that last November, a jury in a small Alaska town rendered a unanimous verdict for Philip Morris in the first wrongful death case challenging cigarettes as defective to go to trial in the state. One would not expect the judge to order the plaintiff, Dolores Hunter, who lost her husband to cancer, to pay Philip Morris's legal fees. She was not required to do so. The same can be expected in most other cases in which a person claims that the actions of a major

employer caused a physical injury or death.

Under Alaska law, a prevailing party may seek a relatively small portion of his or her attorneys' fees ranging from one percent to thirty percent depending on whether the case was contested or uncontested, resolved with or without a trial, and on the amount of the judgment.⁴ But Alaska law provides the judge with ten potential reasons to depart from this schedule. Among these reasons is "the extent to which a given fee award may be so onerous to the non-prevailing party that it would deter similarly situated litigants from the voluntary use of the courts." This factor disfavors imposing fees on individual plaintiffs who sue businesses. Another factor is "the extent to which the fees incurred by the prevailing party suggest that they had been influenced by considerations apart from the case at bar, such as a desire to discourage claims by others against the prevailing party or its insurer." This factor counsels against awarding defense costs to a business that has made the strategic decision to vigorously fight each case to discourage plaintiffs' lawyers, who might smell easy money from piling on more claims.

Despite the law's 10 exceptions, the Alaska Supreme Court developed one more—a broad "public interest" exception that favored plaintiffs.⁵ "The exception the court created meant that if an environmental group sued to stop a development and lost, it did not have to pay the costs incurred by the other side," noted John Harris, the Speaker of the Alaska House of Representatives, "And, by the way, if the group won on any part of its lawsuit—no matter how small or technical—it would be reimbursed 100 percent of its attorneys fees."⁶ The Alaska Legislature found that this exception resulted in "unequal positions in litigation," and after three decades of use, eliminated it in 2003.⁷ While the Alaska Supreme Court permitted the legislature's intervention, the court pointed out that the final exception to the state's loser-pays rule, a catchall that allows the court to reduce or not award attorneys' fees due to "other equitable factors deemed relevant," still provided judges with significant discretion not to award fees on a case-by-case basis.⁸

Given the Alaska law's modest right to reimbursement and significant judicial discretion, it is not surprising that an empirical study of the law conducted by the Alaska Judicial Council concluded that loser pays "seldom plays a significant role in civil litigation."⁹ Courts awarded fees in only about 10 percent of cases, because many were settled, this resulted in verdicts where neither party prevailed or both parties prevailed in some respect, or a contract or other statute governed the fee award. The three quarters of fee awards were for less than \$5,000. In more than half the cases in which the court awarded attorneys' fees, the prevailing party did not pay because the losing party was judgment proof or declared bankruptcy, or because the prevailing party waived fees as part of a post-judgment settlement. Just one in three litigators surveyed could recall a case in which the loser-pays rule played a part in a client's decision to file a lawsuit or to settle a case. The Judicial Council observed that the rule did not seem to have an impact on the filing of frivolous claims, while recognizing that it is difficult to measure such an impact. In fact, plaintiffs' lawyers were among the groups expressing the greatest support for the loser-pays law. More than two-thirds of plaintiffs' lawyers surveyed expressed the view that loser pays worked to their advantage more often than not.

3. Texas Adopted "Loser Pays."

While many refer to legislation enacted in Texas in 2011 as "loser pays," the new law is actually very different than the "English rule."¹⁰

The Texas law has two components. The first part directs the state's Supreme Court to develop a system for dismissing claims at an early stage. Texas was the only state without such a mechanism. Under the new law, the prevailing party on a motion to dismiss is entitled to its attorneys' fees. Courts are very reluctant to grant motions to dismiss, which come soon after filing and before a party has had an opportunity to gain evidence through discovery. Nevertheless, defendants often make such a motion when the legal grounds for a claim are questionable. If adopted elsewhere, legislation based on this provision

of Texas law is likely to discourage defendants from seeking early dismissal of weak cases because, unless they fully prevail, defendants would then have to pay the plaintiff's attorneys' fees for responding to the motion. Instead, defendants will wait until later in the case and make what is known as a motion for summary judgment after incurring significant expense in the discovery process.

The second component of the new Texas law makes minor modifications to what is known as an "offer of judgment" rule. This is a relatively common mechanism available in federal and many state courts in which a plaintiff is required to pay certain court costs when he or she previously rejected a settlement offered by the defendant and a trial ultimately resulted in a verdict that was significantly less favorable than the settlement offer.¹¹ Such laws typically provide only nominal reimbursement of court expenses, which may be less than the cost of seeking such recovery. While the Texas statute provides for substantially greater reimbursement of costs than permitted in federal and other state courts, there are various reasons why this system is rarely used and poses a significant risk for defendants.¹² It is not a very effective mechanism for discouraging meritless lawsuits, and ultimately, it penalizes a party that exercised its right to have the dispute decided in court rather than settle.

OPTIONS FOR DEVELOPING A "LOSER PAYS" SYSTEM

While a loser-pays system similar to the English Rule may not be effective in the United States, legislators have other tools available to them. When legislators discuss the need for loser pays, the phrase is often followed by "...for frivolous lawsuits." State legislators might therefore best focus their interest in loser pays by supporting legislation that requires those who bring frivolous lawsuits to pay the attorneys' fees and expenses of those who are on the receiving side of such lawsuits.

There is a significant difference between a loser-pays rule that requires a party that brought a viable claim but ultimately did

not meet the burden of proof set by law to pay an opponent's attorneys' fees, and one that imposes such costs on those who bring frivolous claims. A "frivolous claim" is typically defined as one that (1) is presented for an improper purpose, such as harassment; (2) is not supported by existing law or a legitimate argument for extending, modifying, or reversing existing law or for establishing new law; or (3) is not supported by the facts and is unlikely to have evidentiary support after a reasonable opportunity for further investigation or discovery.

The need for such reform is greatest in states that follow the approaches used in states that follow the approach currently used in federal courts (known as "Rule 11"). In 1993, the federal judiciary amended the federal rule rendering it, in the words of Justices Scalia and Thomas, "toothless" and allowing "parties . . . to file thoughtless, reckless, and harassing pleadings, secure in the knowledge that they have nothing to lose."¹³ In federal courts, an individual or business that is hit with a frivolous claim must draft a motion for sanctions, provide an advance copy to the plaintiffs' attorney, and give him or her 21 days to withdraw the lawsuit and walk away Scott free. If the plaintiff chooses to proceed with the lawsuit, then the defendant still has little likelihood of recovering his costs. Even if a court finds the lawsuit frivolous, the judge has complete discretion as to whether to sanction such conduct. When the judge finds sanctions are warranted, the rule limits any monetary sanction to the amount needed to discourage such claims. Rule 11 awards are not permitted to be used for the purpose of compensating the victim of the frivolous lawsuit. In fact, the court could decide to impose a fine payable into the court, rather than fees to the injured party.

Legislators might consider adopting a law similar to the federal rule that was in place between 1983 and 1993. About a third of the states apply this version of the rule, which does not include the "21-day safe harbor," provides for mandatory sanctions if a judge finds a case is frivolous, and recognizes that sanctions can serve the legitimate function of compensating a wrongly-sued party for its losses in defending itself.

A second option is to consider approaches adopted in states such as Florida, Georgia, Michigan, or Nebraska that generally requires courts to award a prevailing party its reasonable attorneys' fees and costs when the court finds a lawsuit was frivolous.¹⁴ Wisconsin is the most recent state to take such action by providing a more limited "safe harbor" than the federal rule, and permitting use of sanctions to reimburse victims of frivolous lawsuits.¹⁵

Legislation introduced in Indiana in the 2011 session provides a third approach. The Indiana bill would have required courts, at the conclusion of every case, to evaluate whether the losing party (1) brought the action or defense on a claim or defense that is frivolous, unreasonable, or groundless; (2) continued to litigate the action or defense after the party's claim or defense clearly became frivolous, unreasonable, or groundless; or (3) litigated the action in bad faith. If so, then the court would award reasonable attorneys' fees to the prevailing party.¹⁶

Finally, in addition to strengthening laws against frivolous claims, legislators might consider adopting a "vexatious litigant" law, which typically requires

pro-se plaintiffs (individuals who file lawsuits without an attorney) who repeatedly file and lose lawsuits to obtain permission from the court and post security before filing additional litigation. Such laws have been enacted in states such as California, Florida, Hawaii, Ohio, and Texas.

These options are not intended to be exclusive. Legislators should develop alternatives that (1) are fair to both sides; (2) discourages meritless litigation; and (3) are enforceable in practice, not merely in theory.

Some state courts may view any type of loser-pays legislation as intruding on their judicial authority to develop procedural rules. There is a strong argument, however, that such laws are substantive in nature—they do not merely address the timing for, or manner of, filing a document with the court. Rather, such laws address the very substantive matter of when and how a victim of lawsuit abuse can recover a true financial loss. Legislators can appreciate that such measures are firmly within the tradition of protecting the state's citizens from misconduct, and the legislature's prerogative to reduce barriers to economic growth. 🗳️



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¹See, e.g., Marie Gryphon, *Greater Justice, Lower Cost: How a "Loser Pays" Rule Would Improve the American Legal System*, Civil Justice Rep. No. 11 (Manhattan Inst. 2008); Walter Olson & David Bernstein, *Loser-Pays: Where Next?*, 55 Md. L. Rev. 1161 (1996).

²See Herbert M. Kritzer, "Loser Pays" Doesn't, *Legal Affairs* (Nov. 2005), at http://www.legalaffairs.org/issues/November-December-2005/argument_kritzer_novdec05.msp.

³See, e.g., Chuck Poochigian, *Using the ADA to Abuse the Legal System*, *Union Tribune*, Apr. 8, 2005; Walter Olson, *The ADA Shakedown Racket*, *City Journal* (Winter 2004).

⁴See Alaska Court Rule 82.

⁵See, e.g., *Dansereau v. Ulmer*, 955 P.2d 916 (Alaska 1998); *Southeast Alaska Conservation Council, Inc. v. State*, 665 P.2d 554 (Alaska 1983); *Thomas v. Bailey*, 611 P.2d 536 (Alaska 1977); *Gilbert v. State*, 526 P.2d 1131 (Alaska 1974).

⁶Rep. John Harris, *Loser-Pays in Alaska: The Way it Should Be*, *PointofLaw.com* (July 30, 2007), at <http://www.pointoflaw.com/columns/archives/004140.php>.

⁷H.B. 145 (Alaska 2003).

⁸See *State v. Native Village of Nunapitchuk*, 156 P.3d 389, 405 (Alaska 2007).

⁹Alaska Judicial Council, *Alaska's English Rule: Attorney's Fee Shifting in Civil Cases* (1995).

¹⁰See H.B. 274, 82nd Leg., Reg. Sess. (Tex. 2011).

¹¹The federal offer-of-judgment mechanism, Rule 68 of the Federal Rules of Civil Procedure, was adopted in 1937.

¹²See Michael Logan, Zach Mayer & Aaron Speer, *Offer of Settlement in Texas vs. Offer of Judgment in Federal Court*, Feb. 2011, at <http://www.krcl.net/index.php?src=gendocs&ref=Litigation-Alert%202011%200201>.

¹³Amendments to Federal Rules of Civil Procedure and Forms, 146 F.R.D. 401, 507-08 (1993) (Scalia, joined by Thomas, J.J., dissenting).

¹⁴Fla. Stat. Ann. § 51.105(1); Ga. Code Ann. § 9-15-14; Mich. Comp. Laws § 600.2591; Neb. Rev. Stat. § 25-824(4).

¹⁵S.B. 1, § 28, Spec. Sess. (Wis. 2011) (to be codified at Wis. Stat. § 895.044).

¹⁶S.B. 85 (2012) (proposing amendment to Ind. Code § 34-52-1-1).